United Nations A/57/151

General Assembly

Distr.: General
2 July 2002

Original: English

**Fifty-seventh session**
Item 86 (e) of the preliminary list*
**Macroeconomic policy questions**

# International financial system and development

## Report of the Secretary-General

*Summary*

The present report, responding to General Assembly resolution 56/181 of 21 December 2001, describes recent developments in the international financial system that have a special relevance to development, bearing in mind the outcome of the International Conference on Financing for Development. It contains estimates of the mainly negative net transfer of financial resources of groups of developing countries in 2001 and updates developments in the past year in international financial reform. Specific conclusions are shown in boldface type in the body of the report.

* A/57/50/Rev.1.

02-46961 (E) 130802

# Contents


| | | Paragraphs |
|---|---|---|
| I. | Introduction | 1–3 |
| II. | Net transfer of financial resources of developing countries | 4–9 |
| III. | Reform of the international financial system | 10–48 |
| | A. International standards and codes and their implementation | 11–21 |
| | B. Cooperation to combat corruption, money-laundering and terrorist financing | 22–26 |
| | C. Review of surveillance and conditionality in the Bretton Woods institutions | 27–30 |
| | D. New thinking about sovereign debt restructuring | 31–36 |
| | E. Official financing for crisis resolution | 37–48 |
| IV. | Conclusion: enhancing the coherence and consistency of the international monetary, financial and trading system in support of development | 49–54 |

Page
3
3
4
5
6
7
8
9
11

# I. Introduction

1. The General Assembly has been considering in annual debates since its fiftieth session the opportunities and challenges of international financial flows of developing countries. The opportunities were mainly seen in the contribution such flows could make to the financing of development. The challenges were mainly seen in the potential for financial instability embodied in some of these very same flows. At its fifty-sixth session, the Assembly decided to continue to discuss the international financial system and development and requested that the Secretary-General prepare a report on the matter to be submitted to the Assembly at its fifty-seventh session, bearing in mind, inter alia, the outcome of the International Conference on Financing for Development (Assembly resolution 56/181 of 21 December 2001).

2. A separate report highlights the salient features of the financing for development process and the main aspects of the International Conference, which was held at Monterrey, Mexico from 18 to 22 March 2002.[1] The main outcome document of the Conference, the Monterrey Consensus of the International Conference on Financing for Development,[2] has become a new point of departure for policy-making on the interrelations of domestic and international finance, trade and development. The Monterrey Consensus covered more issues than are the subject of the present report, but it also drew a number of policy conclusions about issues considered in General Assembly discussions on the international financial system and development.

3. With this context in mind, this report updates information on the net foreign transfer of financial resources by developing countries and on major developments in selected policy areas since the previous report on this subject was prepared.[3]

# II. Net transfer of financial resources of developing countries

4. For the fifth year in a row, the developing countries have made a net outward transfer of financial resources (see table). This means the net foreign payment of investment income and capital outflow exceeded the developing countries' capital inflow and earnings on their foreign assets. Moreover, it was the third year in a row that the net transfer was an outflow exceeding $100 billion, although the outflow was smaller in 2001 than in 2000.

**Net transfer of financial resources to developing countries, 1993-2001[a]**

(Billions of dollars)

| | *1993* | *1994* | *1995* | *1996* | *1997* | *1998* | *1999* | *2000* | *2001[b]* |
|---|---|---|---|---|---|---|---|---|---|
| Africa, *of which* | 2.5 | 3.6 | 4.5 | -6.9 | -4.6 | 15.1 | 3.8 | -18.3 | -8.9 |
| Sub-Saharan (excluding Nigeria and South Africa) | 11.9 | 6.9 | 6.0 | 7.1 | 6.2 | 10.1 | 12.7 | 3.7 | 4.8 |
| Eastern and Southern Asia | 10.0 | 2.1 | 23.0 | 25.4 | -28.5 | -128.0 | -131.6 | -111.1 | -102.6 |
| Western Asia | 39.0 | 7.7 | 7.4 | 1.2 | 4.2 | 30.4 | -4.7 | -54.6 | -36.2 |
| Latin America and the Caribbean | 14.8 | 20.6 | 1.1 | 4.5 | 27.8 | 48.4 | 12.0 | -2.4 | 0.8 |
| **Developing countries, total** | **66.3** | **33.9** | **36.0** | **24.2** | **-1.3** | **-34.1** | **-120.4** | **-186.4** | **-146.9** |
| Memorandum item: heavily indebted poor countries (HIPC) | 12.2 | 8.5 | 9.4 | 9.3 | 10.2 | 13.0 | 9.4 | 3.6 | 6.5 |

*Source*: *World Economic and Social Survey, 2002* (United Nations publication, Sales No. E.02.II.C.1), chap. II.

[a] Positive numbers are a net inward transfer and negative numbers are a net outward transfer, in each case comprising the net result of all inflows and outflows of investment, lending, official transfers, investment income payments and reserve accumulation. Country groupings are as defined in *World Economic and Social Survey, 2002*.

[b] Preliminary estimate.

5. By definition, the net transfer is the financial offset of the balance of trade in goods and services.[4] Thus, if the trade surplus declines, the outflow declines, as the net transfer of financial resources is the result of concurrent developments in the trade and financial accounts. In 2001, the most significant factors in developing-country trade were the weakness in exports associated with the global economic slowdown and much reduced revenues from tourism and travel following the 11 September terrorist attacks. These factors tended to reduce trade surpluses and increase trade deficits and financing needs. However, for many countries without access to adequate compensating finance, export weakness quickly translated into curtailed imports. Coupled with the reduction in import demand owing to weaker domestic economic conditions, this tended to have the reverse effect on the trade balances. Moreover, on the financial side, the crises in Argentina and Turkey resulted in severe economic contraction and large reductions in imports, inevitable outcomes of the reduction in their external financing.

6. In Africa, Eastern and Southern Asia, and Western Asia, there was a substantial net outward transfer of financial resources in 2001, albeit smaller than that in 2000. The large net outward resource transfers from Eastern and Southern Asia reflected the continuing, but diminishing, consequences of the 1997 financial crisis, as foreign financial institutions continued to reduce their exposure to the region and as official post-crisis loans were being repaid. In Latin America, the preliminary 2001 estimates suggest that there was no net transfer to or from the region as a whole. There was a significant reduction of private financing, but a large increase in official lending to the region.

7. There was a small net inward transfer of financial resources to sub-Saharan Africa and to the heavily indebted poor countries (HIPCs), which are mainly in Africa. As these countries were also hit with low commodity export prices, their financial inflow needs were far from being met, especially as they have very limited access or capacity to service private financial flows. **It remains of critical importance that the international community substantially increase the flow of official development assistance (ODA) and fully provide the appropriate debt reduction for low-income countries, as agreed in the Monterrey Consensus.**

8. Excluding the net foreign payment of interest and profits and the accumulation of official reserves, there was a net financial inflow to developing countries in 2001 of $63 billion.[5] Net official financial flows rose in 2001, mainly because of the increase in international assistance to countries in financial distress, particularly by the International Monetary Fund (IMF). Foreign direct investment (FDI) in developing economies, as a whole, remained robust, if not in all countries, and the terrorist attacks appear to have had limited immediate impact on FDI.[6]

9. However, FDI was the sole net source of private financial inflow; that is to say, there were large net outflows of private credit, lumping all types of lending together. In part, this was the result of continued caution exercised by foreign lenders to emerging markets, as well as constrained developing-country demand for financing. It also reflected the cut-off in private lending to countries in crisis, particularly Argentina and Turkey, as well as net repayments of private credits by several East Asian countries. Owing to the net overall withdrawal of private credit, official flows exceeded net private financial flows for the first time in many years. **More robust, yet sustainable, private financial flows to developing economies are warranted and implementing the domestic and international policies outlined in the Monterrey Consensus is important to rebuilding them.**

## III. Reform of the international financial system

10. As part of its holistic approach to policy, the Monterrey Consensus addressed the ongoing reform of the international financial architecture. It called for sustaining the reform efforts "with greater transparency and the effective participation of developing countries and countries with economies in transition" (para. 53). Over the past year, international work on the reform effort included continuing development of international standards and codes for macroeconomic policy-making and financial regulation. Particular attention was drawn during 2001-2002 to concerns about corporate financial reporting, auditing and governance, especially in developed countries. There was also intensified cooperation on fighting money-laundering and thus both corruption and terrorist financing, and there was further consideration of the public and private role in preventing and resolving economic and financial crises.

In addition, the Bretton Woods institutions reviewed their relationship with countries in economic distress, and considered new approaches to sovereign debt restructuring and the adequacy of official resources to combat economic crises.

## A. International standards and codes and their implementation

11. Various international bodies have been engaged in developing and fostering adoption, especially by developing economies and countries with economies in transition, of key standards and codes of behaviour in several economic and financial areas. The Monterrey Consensus, in addressing this issue, said it was essential to ensure that the implementation of the codes was carried out on a voluntary and progressive basis, with effective and equitable participation of developing countries in their formulation (para. 57).

12. The overall expectation has been that the confidence of potential investors in emerging economies would increase based on the knowledge that their Governments and enterprises followed international standards and codes. It was always understood that the implementation of standards and codes was a long-term strategy for confidence-building. The fact that it was also understood by practitioners that further work was needed to make standards and codes more applicable to emerging market conditions underlines the importance ore adequate participation of such countries in designing these standards, as well as ensuring access to adequate technical assistance to implement them.

### Fallout from accounting scandals

13. Developments over the past year, however, underlined a different issue, namely, the critical importance of thorough implementation of such standards in developed as much as in developing and transition economies; that is to say, there has been a deepening focus over the past year on corporate accounting shortcomings. The adoption of international accounting standards (IAS) has been one of the priority areas of reform for developing and transition economies. Those countries have long been criticized for being lax in complying with the IAS that they formally introduced. However, the recent corporate failures and heightened uncertainty about the strength of balance sheets and earnings of a number of corporations, especially in the United States of America, signal that problems in financial reporting and auditing of companies around the world might be more widespread than imagined.

14. The problem highlighted by recent corporate disclosures is that standards are only as strong as their implementation. They are undermined by poor compliance by firms and by sub-standard auditing that condones poor compliance wherever it may occur. **It is the responsibility of all countries to curtail accounting abuse and restore the confidence of investors in the quality of financial accounts, whether in developed, developing or transition economies. The new International Accounting Standards Board (IASB) can make a major contribution to strong and appropriate accounting standards.[7] In addition, the devising of appropriate incentives for accounting firms to follow agreed professional standards and of disincentives to prevent abuse of these standards warrants greater international attention.**

15. The growing instances of accounting irregularities at major corporations have raised a concern about whether those irregularities might have systemic consequences. The Financial Stability Forum (FSF), which brings together the key financial officials of the major industrialized countries and the main international bodies on financial regulation issues, has taken up this matter. At its seventh meeting in March 2002, FSF discussed financial stability issues arising from the spate of recent large corporate failures. FSF saw the need for rapid progress in strengthening corporate governance, accounting standards and audit quality, while also enhancing corporate public disclosure and the quality and independence of monitoring of firms by investment advisers. Members reviewed initiatives that had been set in train by national authorities and by the key international regulatory bodies and decided to strengthen coordination of this work. FSF will further discuss the issues involved and the possible courses of action at its next meeting in September 2002.

### Outreach by limited membership bodies

16. The concern noted above in the Monterrey Consensus that countries to which standards and codes apply should participate in their development has had a resonance in FSF. The Monterrey Consensus encouraged "ad hoc groupings that make policy

recommendations with global implications", inter alia, to "continue to improve their outreach to non-member countries" (para. 63). Indeed, FSF, at its March 2002 meeting, welcomed and recommended broad dissemination of a report on "Supervisory guidance on dealing with weak banks" that had been jointly prepared by experts from developed and emerging market economies, working through the Core Principles Liaison Group of the Basel Committee on Banking Supervision (BCBS). The Committee, the major international forum on standards for national banking oversight, comprises central bank and regulatory authorities of 10 major industrialized countries (G-10). Its Core Principles Liaison Group includes G-10 and non-G-10 senior supervisors, IMF and the World Bank.

17. In addition, FSF has initiated regional meetings of its own with FSF and non-FSF members in order to enable non-members to inject their perspectives into its work. As of April 2002, two meetings had been held in Latin America and one each in Asia and Central and Eastern Europe. The initial response to these meetings has been positive. **Such efforts as those of FSF and the Basel Committee to broaden the participation in the discussion on financial system vulnerabilities and reforms should be encouraged**.

#### Banking regulation and supervision

18. One of the most important regulatory developments since the 1997-1998 financial crisis is the proposal by BCBS for a new capital adequacy framework to replace the 1988 Basel Capital Accord. The new rules aim to tie banks' capital more closely to their risk exposures, although formulating the new standards has proved difficult.[8]

19. The first draft of the proposed new accord, circulated in June 1999, had received mixed assessments and a revised draft was released in January 2001. There have been strong concerns about parts of this draft as well.[9] One concern is that the revised rules are enormous in number and complexity, while not giving due consideration to the structural characteristics of domestic financial systems in different countries. It has been argued that it would probably be better and more realistic to seek agreement on broad principles and modes of behaviour rather than aim at uniform application of highly complex and prescriptive rules. It has also been suggested that standards should not be set so as to require micro-oversight of the supervised institutions and that caution is necessary so as not to disrupt or destroy settled markets by adopting approaches that could have serious unintended consequences. In particular, new standards should avoid imposing a significant and unwarranted increase in the cost of credit of developing countries or of small and medium-sized enterprises; nor should they create incentives for greater pro-cyclicality in lending.[10]

20. In response to these concerns, BCBS has delayed the implementation deadline, which was initially set at 2004, and agreed to draft a third consultative package. The Committee will focus on reducing the complexity of current proposals, making them more applicable to different domestic financial systems, and seek to refine its determination of the amounts of capital to be set aside to cover different product areas, raising some and reducing others, so that the amount of capital in the global banking system stays at about current levels. Also, before the next draft of the rules is released, an additional review will be made, aimed at assessing the quantitative impact of the proposals on banks and banking systems.

21. At this point, it is not clear what the final product of BCBS will look like or when it will be implemented. **Adequate time is needed to make certain that the new Basel capital framework reflects and reinforces the best contemporary practices and does not put a disproportionate burden on any particular financial market structure, market segment, economic sector or group of countries, underlining the continuing importance of broad consultations and outreach**.

## B. Cooperation to combat corruption, money-laundering and terrorist financing

22. There has been an increasing agreement in all countries of the deep damage done to societies by the corruption of officials and of the valuable assistance that countries can give each other in fighting corruption. One frequently seen aspect of corruption is the disguising and moving of illicitly acquired funds across borders, that is to say, "money-laundering". This can be done through unregulated — in some cases, illegal — money transfer systems; but when the funds are large, the formal financial systems of source and

destination countries are almost inevitably involved in the funds transfers.

23. Corruption is just one source of money for money-laundering; crimes, the drug trade and human trafficking are some other examples. "Laundered" funds are moved across borders through informal and formal financial systems. This applies equally to the financing of terrorism, the funds for which may originate in legal activities. There is thus considerable interest in the abuse of formal and informal financial systems for corrupt, illegal and terrorist purposes.

24. After the 11 September 2001 attacks on New York and Washington, D.C., national authorities and international organizations undertook a number of initiatives to better track and trap funds that had been laundered. In particular, the Security Council established the "Counter-Terrorism Committee" (CTC), which has been reviewing national efforts, country by country, and working with countries to prevent and suppress the financing of terrorist acts.[11] In addition, the Financial Action Task Force on Money Laundering (FATF) in an extraordinary plenary meeting on 29 and 30 October 2001 expanded its mission to include detection and prevention of the misuse of the world financial system by terrorists. This has led it, for example, to develop special guidance, released in April 2002, for financial institutions to help them detect the techniques and mechanisms used in the financing of terrorism.[12]

25. IMF and the World Bank are working in consultation with FATF to complete a comprehensive methodology to assess observance of the standard on anti-money-laundering and combating the financing of terrorism (AML/CFT). Discussions continue with FATF on the options for assessment modalities, including those that could lead to an AML/CFT review under the programme of reviews of standards and codes (ROSCs). **To complement these efforts, enhancing the delivery of technical assistance to developing and transition economies to implement anti-money-laundering initiatives is crucial.**[13]

26. Moreover, the General Assembly launched negotiations in 2002 to create a broad and effective United Nations convention against corruption, which should address corruption in all its aspects, including the repatriation of funds illicitly acquired (resolution 56/260 of 31 January 2002). The States Members of the United Nations committed themselves in the Monterrey Consensus to finalizing this convention as soon as possible and also to promoting stronger cooperation to eliminate money-laundering (para. 65). **Meanwhile, it is also important that all countries ratify and implement fully the United Nations instruments to counter the financing of terrorism, freeze terrorist assets, establish financial intelligence units and ensure the sharing of information.**[14]

## C. Review of surveillance and conditionality in the Bretton Woods institutions

27. In response to the past policy failures and the long-running disappointment with the economic situation in many low-income countries — as well as the realization that policy-making has to be domestically "owned" in order to be effectively implemented — the Bretton Woods institutions have been reassessing their relationship with the countries that they support. They have also been concerned about global risks that might emanate from policy inconsistencies among the major industrialized countries and the potential volatility of international financial markets. Each of these concerns was reflected, as well, in the Monterrey Consensus (paras. 54-56). The 2002 "Spring meetings" of the Bretton Woods institutions took stock of policy in a number of specific areas in this regard.

28. The International Monetary and Financial Committee (IMFC), in its April meeting, reviewed the reform of IMF policies on surveillance and the policy conditions for the use of Fund resources.[13] Concerning surveillance, it agreed that IMF should place stronger emphasis on assessing the global impact of policies in individual countries, particularly the largest, as well as on international vulnerabilities that may arise from instability in individual countries and international financial markets. In addition, more candid and comprehensive assessments of exchange arrangements should be made. The Committee also decided that in assessments of matters outside the core expertise of IMF, the Fund should draw more effectively on non-Fund sources, as well as further integrate the work on multilateral and regional surveillance with its traditional country-level surveillance conducted under Article IV consultations.

29. The aim of the review of conditionality associated with the use of Fund resources has been to focus better on priorities, in other words, on macroeconomic and structural policies that are critical to the objectives of the programme — and to strengthen national ownership of reform programmes. However, the streamlining of IMF conditions must not be accompanied by an expansion of conditionality by the World Bank and regional development banks. The test of the success of this conditionality review will be less in the formulation of new policy guidelines than in how the new approach is implemented.

**The overall burden of conditionality must be reduced**

30. A theme that permeates the recent reviews of creditor and donor relationships with recipient countries is that of enhanced national ownership of policy programmes. The mechanism to put this thinking into practice in low-income countries is the consultative process for developing the Poverty Reduction Strategy Papers (PRSPs). The joint IMF/World Bank Development Committee observed in April 2002 that progress had been made in enhancing ownership, but it also recognized that there was scope for improvement, notably in extending participatory processes for the elaboration and monitoring of PRSPs, implementing pro-poor growth policies, and better aligning the programmes of multilateral and bilateral development agencies with country strategies.[16] **In sum, while there have been encouraging developments in the "PRSP approach", as in the reviews of surveillance and conditionality, these should be seen as works in progress that warrant continued international attention.**

## D. New thinking about sovereign debt restructuring

31. It has been recognized that the change in the composition of external creditors of emerging markets, in particular the substitution of bond financing for a considerable share of commercial bank lending, has made the mechanisms used for orderly restructuring of unsustainable sovereign debt in the late 1980s and early 1990s insufficient. In addition, the recent international strategy to involve private creditors more intensively in the resolution of sovereign debt crises has had a number of ambiguities, leaving the markets uncertain about how their claims would be treated in a crisis situation. Whether or not official and private creditors of a sovereign debtor in crisis would be treated comparably has also become a source of dispute. There is also a concern that some countries may have exited their debt restructuring exercises without a sustainable debt situation.

32. The Monterrey Consensus sought to orient international policy reform, in this regard, when it emphasized "the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors" (para. 51).

33. Two broad approaches to reform of the debt workout mechanism are now being explored.[17] The first approach involves creation of a sovereign debt restructuring mechanism (SDRM), which would establish a statutory framework that would make it easier for a sovereign debtor and a specified majority of its creditors to reach what should be an effective debt restructuring agreement that would be binding on all involved creditors. The proposed workout procedures are loosely modelled on Chapter 11 of the United States Bankruptcy Code, which deals with corporations. Currently, work on the legal, institutional and procedural aspects of the proposal is under way. The implementation of the proposal could require new international treaties, changes in national legislation, or amendments to the Articles of Agreement of IMF. This would take time. According to IMF, even with unanimous political support (which is not anticipated), SDRM could not be in place for at least two to three years.

34. The second approach aims to achieve much the same results as the statutory approach, but in a decentralized manner, by encouraging debtors to change the terms of their bond contracts. Under this approach, each sovereign borrower would introduce new clauses aimed to facilitate reaching a debt restructuring agreement should the country have a debt crisis. Advocates of this approach argue that the international official sector should work with borrowers and creditors to draw up clauses that would be as effective as possible and to create incentives to encourage the incorporation of the new terms in debt contracts.[18] It is believed that the second approach could be implemented much faster than SDRM.

35. Most lenders as well as many borrowers are concerned that the invoking of an SDRM in the event of a sovereign debt-servicing crisis might limit their options. This concern gives them an incentive to quickly develop alternatives within the contractual approach, especially as work is advancing on developing the SDRM proposal. Consequently, the two-pronged strategy of reform, compared with commitment at this point to either approach in isolation, has a built-in mechanism that may speed up innovation and development of a comprehensive approach to resolving debt crises.

36. Government leaders in adopting the Monterrey Consensus said that "to promote fair burden-sharing and minimize moral hazard, we would welcome consideration by all relevant stakeholders of an international debt workout mechanism, in the appropriate forums, that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner" (para. 60). **In order to carry out these Monterrey guidelines, it is important that the international consideration of the major debt reform proposals be as inclusive as possible in order to be as effective as possible**.

## E. Official financing for crisis resolution

37. Along with the efforts to prevent and resolve financial crises, the international community has a long-standing responsibility to provide adequate financial support to assist countries in undertaking appropriate economic adjustments to balance-of-payments problems. Overall responsibility in this regard is assigned to IMF, although other multilateral financial institutions and bilateral donors and creditors may also support the adjustment programmes. Indeed, in a world of liberalized capital movements, the counter-crisis campaigns of recent years have entailed mobilization of very large amounts of funds. The Monterrey Consensus underlined "the need to ensure that the international financial institutions, including IMF, have a suitable array of financial facilities and resources to respond in a timely and appropriate way in accordance with their policies" (para. 59). The question addressed over the past year was whether or not this has been the case.

### IMF resources

38. Recently, IMF has made substantial commitments of funds to a number of emerging market economies, as a result of which its "usable resources" have fallen significantly.[19] The Fund remains financially sound and, if need be, it can borrow substantial financial resources from member countries in a position to lend them through the New Arrangements to Borrow and the General Arrangements to Borrow. However, being able to deploy a large amount of its own resources should an emergency arise is generally viewed as the Fund's soundest position from which to operate.

39. In January 2002, IMF began the Twelfth General Review of Quotas, which could lead to an increase in its lendable resources. **As past IMF quota increases failed to keep pace with the growth of world output, international trade or especially capital flows, a substantial increase in quotas is warranted**.

40. Not only do quotas serve as the primary source of lendable IMF resources, but their allocation to countries also determines the limits for borrowing from the Fund of each member and its votes in Fund governance. It is widely recognized that the quota structure has not fully reflected changes in the world economy and the relative economic position of member countries over time.[20] **Arriving at a consensus on a new quota formula that addresses the allocation of quotas as well as their total amount should be a priority**.

41. Along with an adequate amount of resources, there needs to be an adjustment of the forms of their provision in a timely fashion to changing circumstances. Since the 1997-1998 crisis, IMF has designed two new facilities, while four little-used facilities have been eliminated. The new facilities, the Supplemental Reserve Facility (SRF) and the Contingent Credit Line (CCL), were introduced in 1997 and 1999, respectively. SRF was established to provide large, relatively short-term loans to countries hit by capital-account crisis. Recently, there have been proposals to set limits to the amount of lending through the SRF. However, it has been argued that such limits may diminish the effectiveness of the SRF in restoring market confidence and thereby raise the risk of contagion. Hence, changes in policy that would limit access to the SRF need very careful consideration.

42. The CCL was designed to manage contagion. Besides providing external liquidity during an

emergency, it is seen to have a preventive function that, by providing an agreed credit line in advance, could help inhibit a sudden withdrawal of external credit. However, its implementation has been a disappointment. As of June 2002, no member country had availed itself of the facility despite its modification in 2000 to make it more attractive to recipients. The key problem is that potential users of the facility are concerned that application for it would in itself raise suspicions in the market that their financial situation had weakened, thereby reducing rather than strengthening confidence in the country. **One proposal that might be considered is to add to IMF surveillance an option to automatically qualify a country for the CCL if it meets certain benchmarks in its annual Article IV consultation.**

### Other multilateral resources

43. While IMF takes the lead role in negotiating financial rescue programmes and their financial packages, other multilateral financial institutions and bilateral donors or creditors have in many cases provided complementary financing, especially for social imperatives during an adjustment period. In this context, in May 2002, the World Bank introduced a structural adjustment counterpart to the CCL, the "deferred drawdown option" (DDO), to protect core structural programmes should a country face reduced access to international financial markets. A DDO gives borrowers the option of deferring the adjustment loan's disbursement for up to three years, provided that overall programme implementation and the macroeconomic framework remain adequate.

44. The DDO, like most structural adjustment and sector lending by the multilateral development banks, carries "non-concessional" borrowing terms. However, the multilateral banks — like IMF through its Poverty Reduction and Growth Facility — also provide highly concessional financing, some of which can be used in support of adjustment efforts. Because a controversy was holding up agreement on replenishment of the resources of the International Development Association (IDA), the concessional facility of the World Bank, for the three-year period beginning in July 2002 ("IDA-13"), the capacity of the World Bank to extend multilateral concessional finance in the short term was in doubt.[21] Meanwhile, negotiations to replenish the African Development Fund (ADF), the soft loan window of the African Development Bank, also extended beyond their targeted conclusion. "ADF IX", covering the period 2002-2004, should have begun operations in January 2002. The countries that draw on the resources of these facilities have incomes that are too low to be able to service the normal loans of these institutions. Agreement among major donors on the IDA-13 controversy appears to have been reached at the end of June 2002. **High priority should be accorded to resolving all differences that have impeded completion of the IDA and ADF replenishments. It may be hoped that the replenishments are fully agreed before this report comes before the General Assembly.**

### Provision of special drawing rights (SDRs)

45. In the 1960s, before the collapse of the Bretton Woods system of semi-fixed exchange rates, IMF created a reserve asset called the special drawing right (SDR) to be used primarily in transactions among central banks to settle payments imbalances. SDRs were allocated to IMF member countries according to their quotas and if countries used them (held less than their allocation), they paid interest on the amounts used and, equally, if they received them on a net basis, they received interest on the amount above the allocation.

46. The IMF membership has not approved a new general SDR allocation for over 20 years. The reason is that a long-term global need to supplement existing reserve assets, an essential requirement for an SDR allocation to be approved, has not been found. As a result, contrary to the initial objective of making the SDR the "principal reserve asset" of the international monetary system, SDRs account for a very small and declining share of reserve holdings.[22] The Monterrey Consensus called for keeping the need for SDR allocations "under review" (para. 59).

47. An exception to the global-need criterion for allocating new SDRs was made in 1997 to allow for a special one-time-only "equity" allocation, which would double cumulative SDR allocations to almost SDR 43 billion (about $54 billion). The special allocation would correct for the fact that more than one fifth of the IMF membership joined after 1981 and has thus never received an SDR allocation (although all countries would receive some of the new SDRs). Because the allocation is structured in a new way, implementation requires ratification of an amendment to the IMF Articles of Agreement, which requires acceptance by three fifths of the IMF membership (110

countries), having 85 per cent of the total voting power. As of end-February 2002, 117 members having 73 per cent of the total voting power had accepted the proposed amendment. As the United States holds about 17 per cent of the voting power, its ratification of the amendment is required to adopt the proposal.

48. Proposals to renew SDR allocations have been increasing in recent years. They include the temporary issue of SDRs during the episodes of world financial crisis,[23] as well as permanent and regular allocations so as to provide resources to countries that have limited access to international private credit and no ability to use their own currencies to settle international claims. The Monterrey Consensus took note of the proposal to use SDR allocations for development purposes (para. 44). There have also been proposals to use SDRs to finance the provision of global public goods and for new modalities of international development cooperation.[24] **Such discussions of strengthening the use of SDRs should be further encouraged.**

## IV. Conclusion: enhancing the coherence and consistency of the international monetary, financial and trading system in support of development

49. One of the insights in the financing for development process that was embedded in the Monterrey Consensus is that neither financial issues, nor trade, nor development cooperation should be considered in isolation.

50. At the country level, the importance of consistency between financial sector development and the degree of capital-account openness is now widely recognized. Equally important, however, is the balance between external financial and trading opportunities. In essence, foreign borrowing is deferred exports (in other words, foreign exchange must be earned in the future to repay foreign exchange borrowed today). Thus, even if a robust domestic financial sector in a developing country appropriately absorbs foreign capital inflows, the situation might become difficult if export opportunities do not also expand adequately. Consequently, open trade, especially of developed-country trading partners, is of vital importance to open finance.

51. Such concerns are reflected, inter alia, when senior international financial officials enter into the policy debates in favour of global trade liberalization and against the protection that countries afford to specific sectors, such as agriculture, textiles and steel. They may also point out that many developed countries still heavily subsidize a number of products, and developing countries that are efficient producers of those products have to compete in third countries against those subsidized products.[25] Enlarging market access for developing countries and phasing out trade-distorting subsidies, especially in agriculture, would benefit the broad majority of people in both rich and poor countries. **Indeed, improving market access of developing countries should be a global priority.**

52. By the same token, senior international trade officials want to see robust international financial flows, not only to increase investment and economic growth in capital-importing countries, but also to facilitate trade itself; that is to say, net transfers of financial resources, recent trends in which were discussed in section II above, allow countries to have surpluses or deficits in their balance of trade, rather than cause them to have to match the total value of imports and exports of goods and services every year. Trade officials should welcome the trade smoothing and investment increasing opportunities from net financial transfers. However, they might be concerned about premature negative net transfers (aggregate trade surpluses) of developing countries. They might equally be concerned about unsustainably large inward transfers, which have implications for excessive growth of external debt relative to the capacity to service it. Countries that fall into debt crises become poor markets for other countries' exports. **Indeed, sustainable financing of trade and investment in developing countries should also be a global priority.**

53. These concerns are reflected in the section of the Monterrey Consensus on systemic issues which begins (para. 52): "In order to complement national development efforts, we recognize the urgent need to enhance coherence, governance, and consistency of the international monetary, financial and trading systems. To contribute to that end, we underline the importance of continuing to improve global economic governance and to strengthen the United Nations leadership role in promoting development".

**54. In the concluding section of the Monterrey Consensus, Governments committed themselves to staying "fully engaged, nationally, regionally and internationally", and went on to outline a set of guidelines (paras. 69-73) on how they would continue "to build bridges between development, finance, and trade organizations and initiatives, within the framework of the holistic agenda of the Conference" (para. 68). With the continuation of the good will embodied in the "Spirit of Monterrey", the international community can meet this challenge. The United Nations Secretariat is committed to fully supporting Governments, partner international institutions and other essential stakeholders in making this critical effort.**

*Notes*

[1] A report of the Secretary-General on the outcome of the Conference has been prepared for the current session of the Assembly (see A/57/...).

[2] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.11.A.7), chap. I, resolution 1, annex. The Monterrey Consensus was adopted by consensus on 22 March 2002.

[3] See report of the Secretary-General entitled "International financial architecture and development, including net transfer of resources between developing and developed countries" (A/56/173 and Add.1 and 2), 11 July and 17 August 2001.

[4] For additional discussion of the terms employed, see *World Economic Survey, 1986* (United Nations publication, Sales No. E.86.II.C.1), annex III.

[5] For additional details, see *World Economic and Social Survey, 2002* (United Nations publication, Sales No. E.02.II.C.1), chap. II.

[6] See United Nations Conference on Trade and Development (UNCTAD), "FDI downturn in 2001 touches almost all regions" (TAD/INF/PR37), 23 January 2002, for a detailed discussion.

[7] In 2001, the International Accounting Standards Committee, which had started in 1973 as a part-time voluntary organization for the harmonization of accounting and auditing standards worldwide, was converted into a full-time standard-setting body, called the International Accounting Standards Board (IASB). International Financial Reporting Standards, as the IASB output will be known, are to be based on the best international practice and are designed to improve on that practice in the light of new demands.

[8] For a discussion of the background to the proposed new Capital Accord, see report of the Secretary-General entitled "Towards a stable international financial system, responsive to the challenges of development, especially in the developing countries" (A/55/187), 27 July 2000, sect. IV.B.

[9] See Andrew Cornford, "The Basel Committee's proposals for revised capital standards: Mark 2 and the state of play", United Nations Conference on Trade and Development, Discussion Papers, No. 156 (September 2001).

[10] That is to say, lending that would disproportionately expand during booms and contract during slowdowns, thereby aggravating the economic cycle.

[11] Formally called the Security Council Committee established pursuant to resolution 1373 (2001) concerning counter-terrorism, CTC had received national reports from 155 Member States and others as of 30 May 2002 (for additional information on CTC, see http://www.un.org/Docs/sc/committees/1373).

[12] See FATF, *Guidance for Financial Institutions in Detecting Terrorist Financing*, Paris, 24 April 2002 (on the Internet at http://www.fatf-gafi.org/pdf/GuidFITF01_en.pdf).

[13] Representatives of IMF, the World Bank, FATF, the United Nations Global Programme against Money Laundering, CTC, the Egmont Group of Financial Intelligence Units and others are working to coordinate technical assistance and develop a better understanding of the demand and supply of technical assistance (TA) on AML/CFT, including the potential gaps and the need for additional resources to build institutional capacity. It is anticipated that there will be a significant need for additional resources for TA and to build institutional capacity.

[14] As of 10 April 2002, only 34 States had ratified the International Convention for the Suppression of the Financing of Terrorism, adopted by the General Assembly on 9 December 1999 and contained in the annex to Assembly resolution 54/109.

[15] Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, Washington, D.C., 20 April 2002, paras. 7-10 and 14 (see *IMF Survey*, vol. 31, No. 8 (29 April 2002), pp. 118-122).

[16] Communiqué of the Joint Ministerial Committee of the Boards of Governors of the World Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries (Development Committee), Washington, D.C., 21 April 2002, para. 4 (see *IMF Survey*, 29 April 2002, pp. 126-127).

[17] For a more detailed discussion of these proposals, see *World Economic and Social Survey, 2002*, chap. II.

[18] At the time of the 2002 Spring meetings of the Bretton Woods institutions, the Group of 7 Finance Ministers and Central Bank Governors, and the G-10 Finance Ministers and Central Bank Governors announced that they had decided to work on the decentralized approach to sovereign debt restructuring (see *IMF Survey*, 29 April 2002, pp. 127-129).

[19] As of March 2002, the Fund's liquidity ratio (the ratio of uncommitted usable resources to liquid liabilities) was 106.1, against 114.9 in 2001 and 163.7 in 2000.

[20] It has also been argued that voting strength in IMF has become excessively dependent on country quotas; that is to say, votes are allocated according to quota size plus "basic votes". Each member country has 250 basic votes plus 1 additional vote for every 100,000 special drawing rights (SDRs) of its quota. Because the number of basic votes per country has never increased, as quotas grew, the ratio of basic votes fell, from about 11 per cent of total votes in 1945 to about 2 per cent now. Raising the number of basic votes per country would raise the relative voting strength of the 157 Fund members (out of 183) that had below-average quotas. To do so, however, would require an amendment of the Fund's Articles of Agreement (see IMF, "Twelfth General Review of Quotas: preliminary considerations and next steps", 22 January 2002, annex 2).

[21] The most contentious issue has been what share of IDA resources should be provided as grants and for what purposes, instead of 35-40 year credits with annual service charges of 0.75 per cent on disbursed balances.

[22] In 2001, SDRs made up roughly 1 per cent of global holdings of foreign reserve assets.

[23] See the report of the Executive Committee on Economic and Social Affairs (ECESA/1/Rev.1) entitled "Towards a new international financial architecture", 25 June 2001, available on the Internet (at http://www.un.org/esa/coordination/ecesa/ecesa-1.pdf).

[24] A proposal along these lines was made at the International Business Forum of the Monterrey Conference (see George Soros, *George Soros on Globalization* (New York, Public Affairs (division of Perseus Books Group), 2002)).

[25] In this regard, developing countries point out that subsidies to agricultural products in developed countries are about $1 billion a day, which is equivalent to six times total official development assistance (communiqué of the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development, Washington, D.C., 19 April 2002, para. 11 (see *IMF Survey*, 29 April 2002, p. 131)).